COUNCIL

TUESDAY 19th SEPTEMBER 2023

REPORT OF THE PORTFOLIO HOLDER FOR OPERATIONS AND FINANCE

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2022/23

EXEMPT INFORMATION

None

PURPOSE

The Annual Treasury report is a requirement of the Council's reporting procedures. It covers the Treasury activity for 2022/23, and the actual Prudential Indicators for 2022/23.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes in accordance with Regulations issued under the Local Government Act 2003. It also provides an opportunity to review the approved Treasury Management Strategy for the current year and enables Members to consider and approve any issues identified that require amendment.

RECOMMENDATIONS

That Council ;

1. **Approve the actual 2022/23 Prudential and Treasury Indicators within the report and shown at Appendix 1; and**

2. **Accept the Annual Treasury Management Report for 2022/23**

EXECUTIVE SUMMARY

This report covers Treasury operations for the year ended 31st March 2023 and summarises:

- the Council's Treasury position as at 31st March 2023; and
- Performance Measurement

The key points raised for 2022/23 are:

1. The Council's Capital Expenditure and Financing 2022/23
2. The Council's Overall Borrowing Need
3. Treasury Position as at 31st March 2023
4. The Strategy for 2022/23
5. Borrowing Outturn for 2022/23
6. Investment Outturn for 2022/23
7. Performance Measurement

8. The Economy and Interest Rates
9. Property Funds
10. Other Issues

The Treasury Function has achieved the following favourable results:

- The Council has complied with the professional codes, statutes and guidance;
- There are no issues to report regarding non-compliance with the approved prudential indicators;
- The Council maintained an average investment balance externally invested of £75.8m and achieved an average return of 2.16% (budgeted at £37.3m and an average return of 0.25%).
- The closing weighted average internal rate on borrowing is 4.05% (4.05% for 2021/22);
- The Treasury Management Function has achieved an outturn investment income of £1.6m compared to an original budget of £121k. Investment balances were higher than budgeted throughout the year, and the average interest rates rose significantly.
- We also received £458k in dividends from our property fund investments (£269k in 2021/22), compared to a budget of £420k. However, the net value of the investments has fallen by £1.12m as at 31st March 2023.

During 2022/23 the Council complied with its legislative and regulatory requirements.

The Executive Director Finance confirms that there was no overall increase in borrowing within the year and the Authorised Limit was not breached.

At 31st March 2023, the Council's external debt was £63.060m (£63.060m at 31st March 2022) and its external investments, excluding property funds and bank account, totalled £60.610m (£68.299m at 31st March 2022).

RESOURCE IMPLICATIONS

There are no financial implications or staffing implications arising directly from the report.

LEGAL/RISK IMPLICATIONS BACKGROUND

The Council is aware of the risks of passive management of the Treasury Portfolio and with the support of Link Asset Services, the Council's current Treasury advisers, has proactively managed its debt and investments during the year.

EQUALITIES IMPLICATIONS

None

SUSTAINABILITY IMPLICATIONS

None

REPORT AUTHOR

If Members would like further information or clarification prior to the meeting please contact Joanne Goodfellow, telephone 01827 709241 or email joanne-goodfellow@tamworth.gov.uk

LIST OF BACKGROUND PAPERS

- Local Government Act 2003;
- Statutory Instruments: 2003 No 3146 & 2007 No 573;
- CIPFA Code of Practice on Treasury Management in Public Services;
- Treasury Management Strategy 2022/23 (Council 22nd February 2022);
- Treasury Management Mid-Year Review 2022/23 (Council 13th December 2022);
- Treasury Outturn Report 2021/22 (Council 27th September 2022).

APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Borrowing and Investment Rates

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2022/23 the minimum reporting requirements were complied with:

- an annual treasury strategy in advance of the year (Council 22nd February 2022)
- a mid-year (minimum) treasury update report (Council 13th December 2022)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, Cabinet has received quarterly Treasury management updates as part of the Financial Healthcheck Reports.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members. This Council confirms that it has complied with the requirement under the Code to provide scrutiny of all of the above Treasury Management Reports to the Audit and Governance Committee. Member training on Treasury Management issues was provided in February 2023 and further training is planned during 2023/24.

During 2022/23, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows.

Prudential & Treasury Indicators	2021/22 Actual £m	2022/23 Estimate £m	2022/23 Actual £m
Capital Expenditure			
Non HRA	7.823	28.483	**4.889**
HRA	9.993	20.887	**13.876**
Total	17.816	49.370	**18.765**
Capital Financing Requirement			
Non HRA	3.937	5.029	**3.785**
HRA	69.893	70.590	**69.982**
Total	73.830	75.619	**73.767**
Gross Borrowing			
External Debt	63.060	63.060	**63.060**
Investments			
Longer than 1 year	13.095	-	**10.842**
Less than 1 year	67.215	15.829	**60.490**
Total	80.310	15.829	**71.332**
Net Borrowing	-17.250	47.231	**-8.272**

It should be noted that **£29m** of Capital scheme spend has been re-profiled into 2023/24 (also including re-profiling from previous years) which has increased investment balances.

Other prudential and treasury indicators are to be found further in this report. The Executive Director Finance confirms that there was no overall increase in borrowing in year and the statutory borrowing limit (the authorised limit) was not breached.

1. The Council's Capital Expenditure and Financing 2022/23

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply internal funds, the capital expenditure would give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2021/22 Actual £m	2022/23 Estimate £m	2022/23 Actual £m
Capital Expenditure	7.823	28.483	**4.889**
Financed in year	7.340	27.920	**4.837**
Unfinanced capital expenditure	0.483	0.563	**0.052**
HRA	2021/22 Actual £m	2022/23 Estimate £m	2022/23 Actual £m
Capital Expenditure	9.993	20.887	**13.876**
Financed in year	9.993	19.699	**13.788**
Unfinanced capital expenditure	-	1.188	**0.088**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2022/23 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2022/23 MRP Policy (as required by DLUHC Guidance) was approved as part of the Treasury Management Strategy Report for 2022/23 on 22nd February 2022.

The Council's CFR for General Fund and the HRA for the year are shown below, and represent a key prudential indicator.

CFR: General Fund	31st March 2022 Actual £m	31st March 2023 Budget £m	31st March 2023 Actual £m
Opening balance	3.612	4.096	**3.937**
Add unfinanced capital expenditure (as above)	0.483	0.563	**0.052**
Less MRP/VRP	(0.158)	(0.217)	**(0.204)**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	3.937	4.441	**3.785**

CFR: HRA	31st March 2022 Actual £m	31st March 2023 Budget £m	31st March 2023 Actual £m
Opening balance	69.893	69.990	**69.893**
Add unfinanced capital expenditure (as above)		1.188	**0.088**
Less MRP/VRP	-	-	**-**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	69.893	71.178	**69.981**

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2022/23. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Gross borrowing and the CFR	31st March 2022 Actual £m	31st March 2023 Budget £m	31st March 2023 Actual £m
Gross borrowing position	63.060	63.060	63.060
CFR	73.831	75.619	73.767
Under / Over funding of CFR	-10.771	-12.559	-10.707

The lower than estimated CFR reflects re-profiling of spend within the capital programme to 2023/24 and lower than forecast borrowing.

The Authorised Limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

The Operational Boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual Financing Costs as a Proportion of Net Revenue Stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Borrowing Limits	GF £m	HRA £m	Total £m
Authorised limit	8.029	79.407	87.436
Maximum gross borrowing position	-	63.060	63.060
Operational boundary	-	63.060	63.060
Average gross borrowing position	-	63.060	63.060
Budgeted financing costs as a proportion of net revenue stream %	(0.17)	28.09	27.91
Actual financing costs as a proportion of net revenue stream %	(26.85)	29.60	2.74

3. Treasury Position as at 31st March 2023

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2022/23 the Council's treasury (excluding borrowing by finance leases) position was as follows:

General Fund	31st March 2022 Principal £m	Rate/ Return %	Average Life yrs	31st March 2023 Principal £m	Rate/ Return %	Average Life yrs
Total debt	**-**	**-**	**-**	**-**	**-**	**-**
CFR	***3.937***	**-**	**-**	***3.785***	**-**	**-**
Over / (under) borrowing	***(3.937)***	**-**	**-**	***(3.785)***	**-**	**-**
Investments:						
- in house	45.761	0.54	-	44.108	2.16	-
Total investments	***45.761***	***0.54***	**-**	***44.108***	***2.16***	**-**

HRA	31st March 2022 Principal £m	Rate/ Return %	Average Life yrs	31st March 2023 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	63.060	4.05	32.73	63.060	4.05	33.73
Total debt	***63.060***	***4.05***	***32.73***	***63.060***	***4.05***	***33.73***
CFR	***69.893***	**-**	**-**	***69.982***	**-**	**-**
Over / (under) borrowing	***(6.833)***	**-**	**-**	***(6.922)***	**-**	**-**
Investments:						
- in house	21.454	0.54	-	16.382	2.16	-
Total investments	***21.454***	***0.68***	**-**	***16.382***	***2.16***	**-**

Maturity Structures

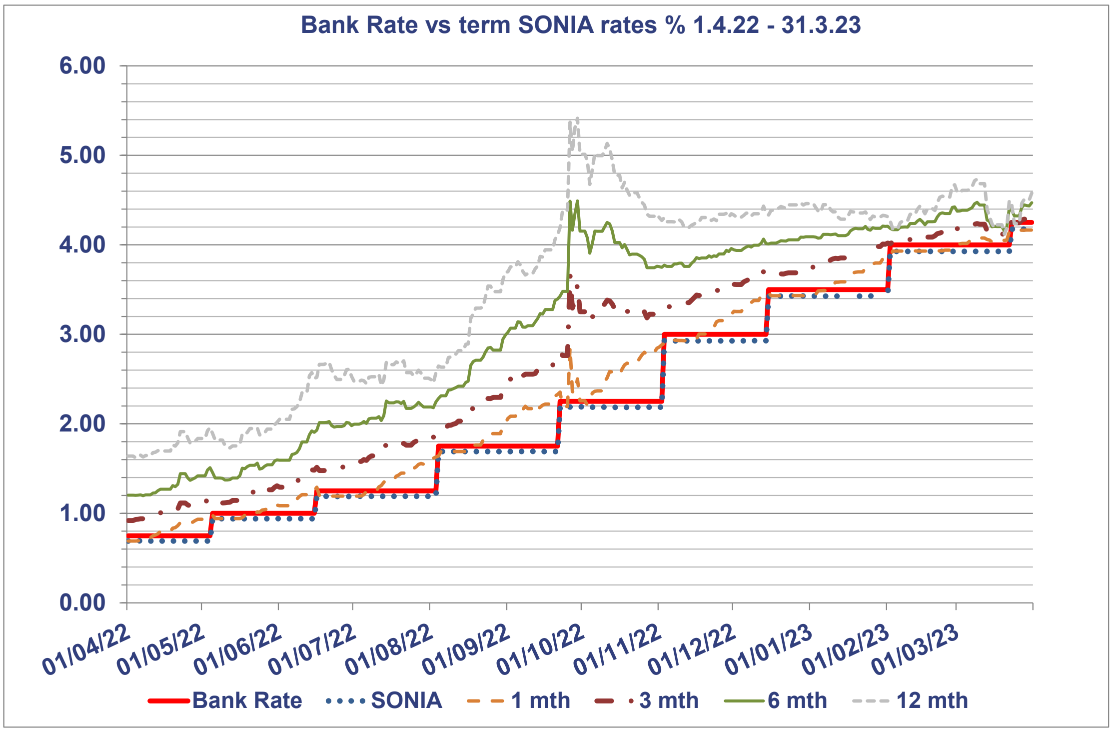
The maturity structure of the debt portfolio was as follows:

Duration	31st March 2022 Actual £m	2022/23 original limits %	31st March 2023 Actual £m
Under 12 months	-	20	**-**
12 months and within 24 months	-	20	**-**
24 months and within 5 years	-	25	**-**
5 years and within 10 years	1	75	**1**
10 years and within 15 years	4	100	**4**
15 years and within 50 years	58	100	**58**

All investments held by the Council were invested for up to one year, with the exception of £11.962m invested in property funds, which are held for the longer-term, 5 – 10 years.

4. The Strategy for 2022/23

4.1 Investment strategy and control of interest rate risk



FINANCIAL YEAR TO QUARTER ENDED 31/3/2023						
	Bank Rate	**SONIA**	**1 mth**	**3 mth**	**6 mth**	**12 mth**
High	4.25	4.18	4.17	4.30	4.49	5.41
High Date	23/03/2023	31/03/2023	31/03/2023	31/03/2023	29/09/2022	29/09/2022
Low	0.75	0.69	0.69	0.92	1.20	1.62
Low Date	01/04/2022	28/04/2022	01/04/2022	01/04/2022	07/04/2022	04/04/2022
Average	2.30	2.24	2.41	2.72	3.11	3.53
Spread	3.50	3.49	3.48	3.38	3.29	3.79

Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24.

The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a wretched Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used.

Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

Nonetheless, while the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the Great Financial Crisis of 2008/9. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

4.2 Borrowing strategy and control of interest rate risk

During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were initially low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry generally remained in place during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns. As the cost of carry dissipated, the Council sought to avoid taking on long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<3 years) as appropriate.

The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this has been kept under review to avoid incurring higher borrowing costs in the future when this Authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Executive Director Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short-term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

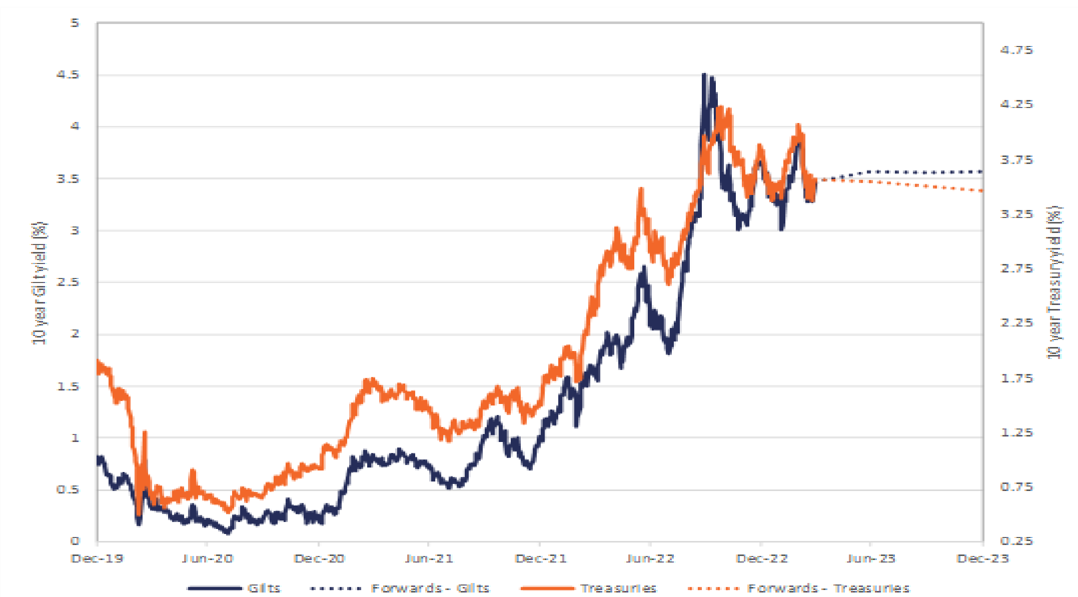
Interest rate forecasts were initially suggesting only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23 but by August it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. Currently the CPI measure of inflation is still above 10% in the UK but is expected to fall back towards 4% by year end. Nonetheless, there remain significant risks to that central forecast.

PWLB Borrowing Rates

PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession.

However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Graph of UK gilt yields v. US treasury yields



Gilt yields have been on a continual rise since the start of 2021, peaking in the autumn of 2022. Currently, yields are broadly range bound between 3% and 4.25%.

At the close of the day on 31 March 2023, all gilt yields from 1 to 5 years were between 3.64% – 4.18%, with the 1 year being the highest and 6-7.5 years being the lowest yield.

Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

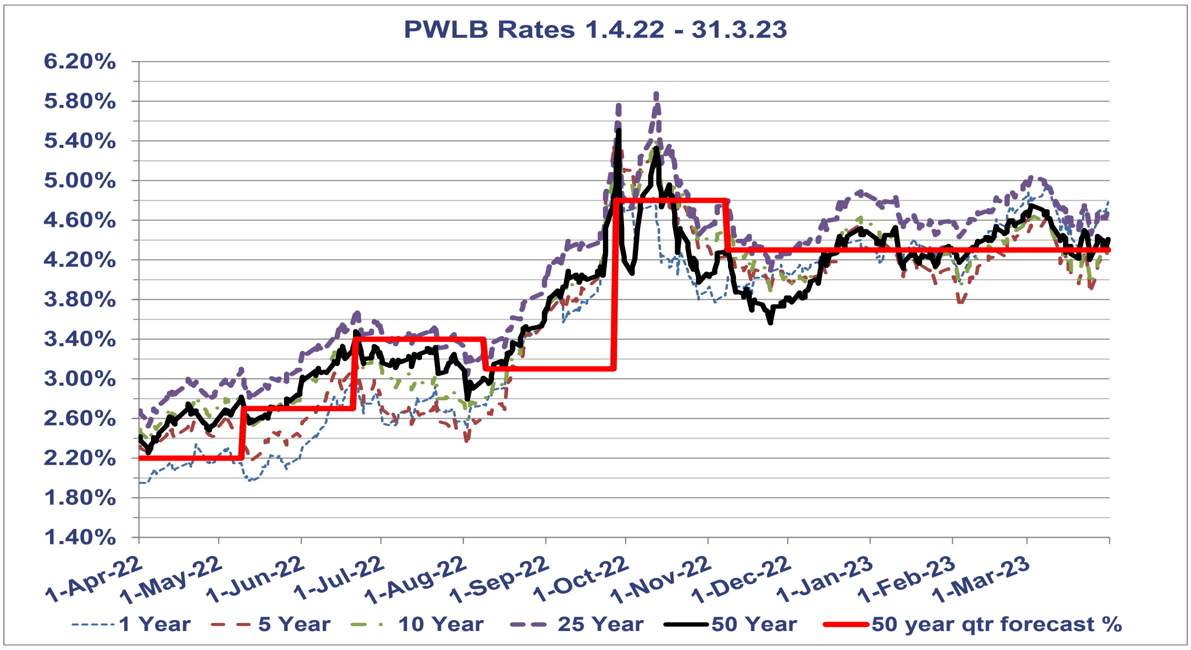
- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target.

As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

The Bank of England is also embarking on a process of Quantitative Tightening, but the scale and pace of this has already been affected by the Truss/Kwarteng "fiscal experiment" in the autumn of 2022 and more recently by the financial market unease with some US (e.g., Silicon Valley Bank) and European banks (e.g., Credit Suisse). The gradual reduction of the Bank's original £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

The graph and tables for PWLB rates below and in Appendix 2 show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



5. Borrowing Outturn for 2022/23

Treasury Borrowing
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Borrowing in Advance of Need
The Council has not borrowed more than, or in advance of, its needs, purely in order to profit from the investment of the extra sums borrowed.

Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Investment Outturn for 2022/23

Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Council on 22nd February 2022. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised the following:

Balance Sheet Resources General Fund	31st March 2022 £m	31st March 2023 £m
Balances	9.155	**9.615**
Earmarked Reserves	15.505	**15.56**
Provisions	1.916	**1.825**
Usable Capital Receipts	13.230	**12.601**
Capital Grants Unapplied	0.420	**0.975**
Total GF	40.226	**40.576**
Balance Sheet Resources HRA	31st March 2022 £m	31st March 2023 £m
Balances	5.717	**2.761**
Earmarked Reserves	11.989	**10.599**
Provisions	-	**-**
Usable Capital Receipts	1.153	**1.710**
Total HRA	18.859	**15.07**
Total Authority Resources	59.085	**55.646**

Investments held by the Council – the Council maintained an average balance of £75.8m of internally managed funds. The internally managed funds earned an average rate of return of 2.16%. The comparable performance indicator is the average 3 month SONIA rate which was 2.72%. This compared with a budget assumption of £37.3m investment balances earning an average rate of 0.25%.

7. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy Statement.

This service has set the following local performance indicator:

- *Average external interest receivable in excess of 3 month SONIA rate;*

Whilst the assumed benchmark for local authorities is the 7 day SONIA rate, a higher target is set for internal performance.

The actual return of 2.16% is compared to the average 3 month SONIA of 2.72% (0.56% below target). This is due to the sharp increase in interest rates between 1st April 2022 and 31st March 2023, with some investments fixed at lower rates at the beginning of the year.

8. The Economy and Interest Rates

UK Economy. Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	**Eurozone**	**US**
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the ILO unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

Our economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

USA. The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%. In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

EU. Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

9. Investment in Property Funds

Investment in property funds was included within the Commercial Investment Strategy, with the aim of generating improved returns of c.4-5% p.a. (plus asset growth) being long term investments of between 5 – 10 years (minimum) in order to make the necessary returns (after set up costs). Utilising the capital receipt proceeds of the sale of the Golf Course, a budget of £12m was allocated to long-term investment in a number of property funds. To date, the Council has invested £1.85m with Schroders UK Real Estate Fund, £6.057m with Threadneedle Property Unit Trust, and £4.057 with Hermes Federated Property Unit Trust. Total investment £11.962m.

Fund Valuations	Investment	Valuation 31/03/2021	Valuation 31/03/2022	Valuation 31/03/2023	Valuation 31/05/2023
Schroders UK Real Estate Fund	1,848,933	1,848,933	2,139,618	1,727,176	1,690,891
Valuation Increase / (reduction)		0	290,685	-121,757	-158,042
Threadneedle Property Unit Trust	2,000,249	1,794,439	2,097,097	1,732,373	1,747,516
Valuation Increase / (reduction)		-205,810	96,848	-267,876	-252,733
Threadneedle Property Unit Trust	4,056,536	N/A	4,407,163	3,640,676	3,672,500
Valuation Increase / (reduction)			350,627	-415,860	-384,036
Hermes Federated Property Unit Trust	4,056,536	N/A	4,450,808	3,741,712	3,760,729
Valuation Increase / (reduction)			394,271	-314,824	-295,807
Total	11,962,255	3,643,372	13,094,686	10,841,937	10,871,635
Valuation Increase / (reduction)		-205,810	1,132,431	-1,120,317	-1,090,619

The Council received £458k in dividends from its property fund investments in 2022/23 (£269k in 2021/22), £1.002m in total since 2018/19, offset against the valuation decrease of £1.12m over the same period.

10. Other Issues

International Financial Reporting Standard (IFRS) 9 – Financial Instruments.

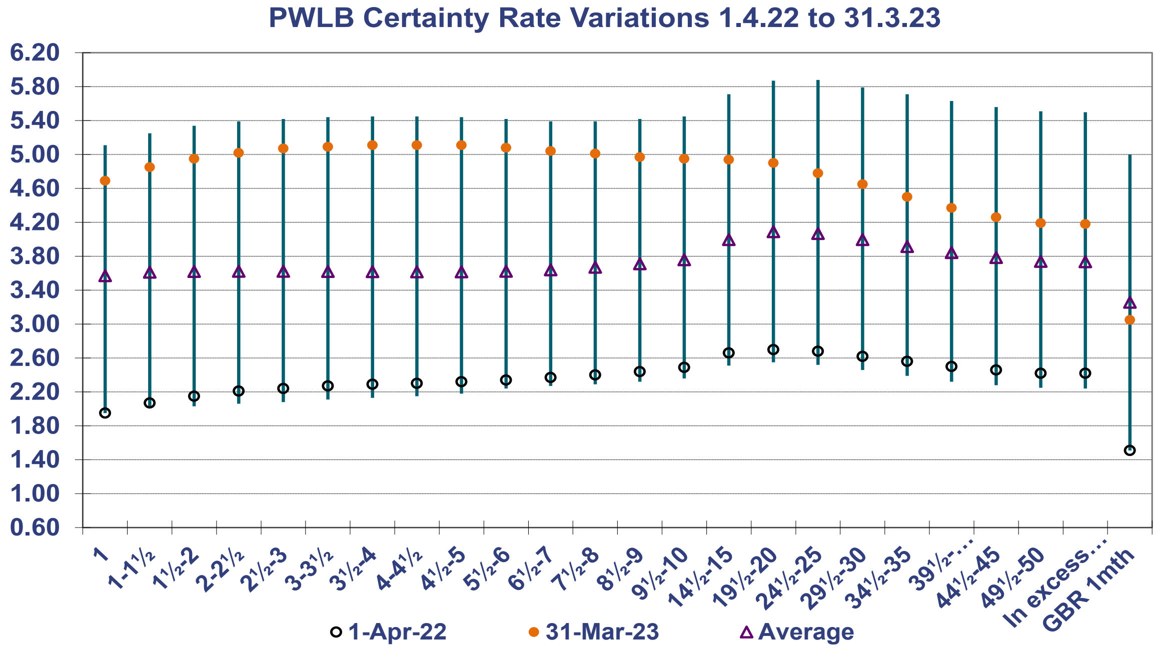
The 2018/19 Accounting Code of Practice introduced changes in way investments are valued and disclosed in the Council's Statement of Accounts. Key considerations are:-

- Expected credit loss model. Whilst not material for vanilla treasury investments such as bank deposits, this does impact our investment in property funds
- The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, will be changed to **Fair Value through the Profit and Loss (FVPL).**

Following the consultation undertaken by the Department of Levelling Up, Housing and Communities [DLUHC] on IFRS 9, the Government has extended the mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds to 31st March 2025. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

1. PRUDENTIAL INDICATORS	2021/22	2022/23	2022/23
Extract from budget and rent setting report	**Actual**	**Original**	**Actual**
Capital Expenditure	**£m**	**£m**	**£m**
Non - HRA	7.823	28.483	4.889
HRA	9.993	20.887	13.876
TOTAL	17.816	49.370	18.765
Ratio of financing costs to net revenue stream	**%**	**%**	**%**
Non - HRA	(6.739)	(0.17)	(26.85)
HRA	28.157	28.09	29.60
Gross borrowing requirement General Fund	**£m**	**£m**	**£m**
brought forward 1 April	3.612	4.096	3.937
carried forward 31 March	4.095	4.658	3.989
in year borrowing requirement	0.483	0.563	0.052
Gross borrowing requirement HRA	**£m**	**£m**	**£m**
brought forward 1 April	69.893	69.990	69.893
carried forward 31 March	69.893	71.178	69.981
in year borrowing requirement	-	1.188	0.088
	£m	**£m**	**£m**
Gross debt	63.060	63.060	63.060
Capital Financing Requirement	**£m**	**£m**	**£m**
Non – HRA	3.937	4.441	3.785
HRA	69.893	71.178	69.981
TOTAL	73.831	75.619	73.766
Annual change in Capital Financing Requirement	**£m**	**£m**	**£m**
Non – HRA	0.325	0.346	(0.152)
HRA	-	1.188	0.088
TOTAL	0.325	1.534	(0.064)

2. TREASURY MANAGEMENT INDICATORS	2021/22	2022/23	2022/23
	Actual	**Original**	**Actual**
	£m	**£m**	**£m**
Authorised Limit for external debt - General Fund			
borrowing	7.736	8.029	8.029
other long term liabilities	-	-	-
TOTAL	7.736	8.029	8.029
Authorised Limit for external debt - HRA			
borrowing	79.407	79.407	79.407
other long term liabilities	-	-	-
TOTAL	79.407	79.407	79.407
Operational Boundary for external debt - General Fund	**£m**	**£m**	**£m**
borrowing	-	-	-
other long term liabilities	-	-	-
TOTAL	-	-	-
Operational Boundary for external debt - HRA	**£m**	**£m**	**£m**
borrowing	63.060	63.060	63.060
other long term liabilities	-	-	-
TOTAL	63.060	63.060	63.060
Actual external debt	**£m**	**£m**	**£m**
	63.060	63.060	63.060



HIGH/LOW/AVERAGE PWLB RATES FOR 2022/23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%